



defined below). Funds request that the Internal Revenue Service rule that income earned from investments in the commodity-linked note described in this letter constitutes qualifying income to the Funds under section 851(b)(2) of the Internal Revenue Code of 1986, as amended (the "Code").

**Facts:**

Fund 1 and Fund 2 (each a "Fund," and collectively the "Funds") intend to elect and to qualify to be taxed as regulated investment companies ("RICs") under section 851(a) of the Code. Each Fund is a series of an open-end management investment company registered under the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., as amended (the "1940 Act"). The Funds are series of Trust, a statutory trust organized under the laws of State.

The Funds are accrual method taxpayers whose annual accounting period ends on Date 1.

The Funds intend to invest in a commodities-linked note having the terms and conditions of the following note (the "Note"). The Note will be issued with a par value of \$a. Its payout formula will be determined with reference to Index. The term of the Note will be b. Each Fund, as holder of the Note, will have the right to put the Note to the issuer at the calculated redemption price based upon the closing Index value as of the end of the next business day after notification to the issuer, or as of the same day closing value if notice is made by nine o'clock in the morning, New York time. In addition, if the Index value falls to a level that is equal to or below c% of the initial reference value on any day, the Note will "knockout" and automatically redeem at the calculated redemption price based upon the closing Index as of the end of the next business day.

The repayment obligation upon early redemption, knockout, or at maturity is calculated under a formula that provides for repayment of the face amount of the Note, increased or decreased by an amount equal to the face amount of the Note multiplied by a leverage factor of d (the "Leveraged Face Amount") multiplied by the percentage of the increase or decrease of the beginning value of Index compared to the ending value of Index for the applicable period. From this amount is subtracted an amount that reflects the reversal of an interest factor that is included in Index. From this amount is subtracted an annual fee amount based on a certain amount of basis points of the face amount of the Note.

The Funds make the following representations with respect to the Note:

- (1) the issuer of the Note will receive payment from each Fund for the Note substantially contemporaneously with the delivery of the Note to the Fund;

- (2) once issued, the Funds will not need to make any additional payments to the issuer of the Note;
- (3) the issuer of the Note is not subject by the terms of the Note to mark-to-market margining requirements of the Commodities Exchange Act, 7 U.S.C. 2, as amended (the “CEA”); and
- (4) the Note is not marketed as a contract of sale of a commodity for future delivery (or option for future delivery on such a contract) subject to the CEA.

### **Law and Analysis:**

Section 851(b)(2) provides that a corporation shall not be considered a RIC for any taxable year unless it meets an income test. Under this test, at least 90 percent of its gross income must be derived from certain enumerated sources. Section 851(b)(2) defines qualifying income, in relevant part, as –

dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), and gains from the sale or other disposition of stock or securities (as defined in section 2(a)(36) of the 1940 Act) or foreign currencies, or other income (including but not limited to gains from options, futures or forward contracts) derived with respect to [the RIC’s] business of investing in such stock, securities, or currencies . . . .

Section 2(a)(36) of the 1940 Act defines the term “security” as –

any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security (including a certificate of deposit) or on any group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Section 2(f)(1) of the CEA provides that the CEA is not applicable to a hybrid instrument that is predominantly a security. Section 2(f)(2) of the CEA provides that a hybrid instrument shall be considered to be predominantly a security if –

(A) the issuer of the hybrid instrument receives payment in full of the purchase price of the hybrid instrument, substantially contemporaneously with the delivery of the hybrid instrument;

(B) the purchaser or holder of the hybrid instrument is not required to make any payment to the issuer in addition to the purchase price paid under subparagraph (A), whether as margin, settlement payment, or otherwise, during the life of the hybrid instrument or at maturity;

(C) the issuer of the hybrid instrument is not subject by the terms of the instrument to mark-to-market margining requirements; and

(D) the hybrid instrument is not marketed as a contract of sale of a commodity for future delivery (or option on such a contract) subject to the CEA.

Section 2(f)(3) of the CEA provides that for purposes of section 2(f)(2)(C) of the CEA, mark-to-market margining requirements do not include the obligation of an issuer of a secured debt instrument to increase the amount of collateral held in pledge for the benefit of the purchaser of the secured debt instrument to secure the repayment obligations of the issuer under the secured debt instrument.

**Conclusion:**

Based on the facts as represented, we rule that income and gain arising from the Note constitutes qualifying income to the Funds under section 851(b)(2) of the Code.

This ruling is directed only to the taxpayers who requested it, and is limited to the facts as represented by the taxpayers. Section 6110(k)(3) provides that this letter may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Robert A. Martin  
Robert A. Martin  
Acting Senior Technician Reviewer, Branch 1  
Office of Associate Chief Counsel  
(Financial Institutions & Products)